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WHY IPE NEEDS TO TALK ABOUT MONEY: ON AUSTERITY, FINANCIAL POWER, AND DEBT

ECONOFICTION CAPITAL, ECONOMY, FINANCE, GELDSCHÖPFUNG, MONEY

The esteemed science fiction writer and Professor of Biochemistry at Boston University, Isaac Asimov once said that the most interesting phrase to hear in science is not 'Eureka! I've found it', but 'gee, that's funny.' It turns out that the 'gee, that's funny' moments are the most exciting because they can set you on a path to find those 'eureka' moments. Ten years ago, when I was a graduate student at York University I had my own 'gee, that's funny' moment. I was having lunch with a well-respected visiting professor of political economy and we were casually discussing the state of the world economy just before the global financial crisis. Eventually, it dawned on me to ask him where money came from in the first place. He said he felt embarrassed, that he used to know, but had somehow forgotten the answer along the way to his professorship.

'Gee, that's funny.'

I figured if one of the world's leading critical political economists didn't seem to care much about how new money entered the economy, then it might not be important. At the time, I was finalising my PhD on what I thought (at the time) was a completely different topic, so I didn't think to pursue my question any further. But not knowing continued to gnaw on me, particularly because I considered myself a critical political economist and this means a critical engagement with the history, theory and practice of capitalist accumulation. If the main goal of capitalists is the pursuit of evermore money, it would be a pretty good idea, I thought, to know how new money is produced.

Surprisingly, the literature in International Political Economy (IPE) was of very little help in my search. I canvassed all leading IPE textbooks and not one discusses the history of money, how money is produced or the problems and consequences – read: relations of power and inequality – of the present monetary system. I also canvassed leading textbooks in political economy that have a less international focus. Same thing. How is it, as scholars and educators of IPE, that we have not addressed these questions? In my estimation, the oversight is nothing short of scandalous given the centrality of money to everyday life, well-being and the ebbs and flows of the global political economy more generally.

With some considerable exceptions in heterodox political economy and sociology, much of the extant literature is uncritical and lacks deep historical and theoretical analysis. At the moment, I'm finalising my literature review for a new book with Richard H.

Robbins called *Money: A Critical Introduction*, due out with Routledge in early 2017. The book aims to offer an accessible introduction to the history, theory and literature on money with a critical analysis of how new money enters the economy and the consequences and power relations that result. We intend it to be a companion volume to our recently published *Debt as Power* with Manchester University Press in the UK and Oxford University Press in the USA.

In *Debt as Power* we consider the ubiquity of debt at all levels of the global economy and argue that debt is a technology of capitalist power known by its effects on bodies, built environments and nature. As we claim in the book:

the world is awash in debt and though we should recognise that debt levels and access to credit are radically unequal within and between countries, the commonality of all modern political economies is not so much that they are market oriented but that they are all debt based political economies. Indeed, as Rowbotham noted: 'the world can be considered a single debt-based economy' (1998: 159). To take an international perspective, according to the global management consulting firm McKinsey and Co., as of 2012 the total outstanding debt across 183 countries was US\$175 trillion (Update: it's now US\$199 trillion as of a 2015 McKinsey Report). In 1990, the same figure was only US\$45 trillion or a 288% increase over the period. As identified in Table 1.1, all categories of debt have increased considerably with government debt, financial industry debt and securitised debt (e.g. mortgages, commercial real estate) leading the categories by percent increase.

Table 1.1 (2012 dollars)

Type of Debt	1990US \$Trillion	2012US \$Trillion	Per
Government Bonds	9	47	42%
Financial Bonds	8	42	42%
Corporate Bonds	3	11	26%
Securitized-Loans	2	13	55%
Non-Securitized Loans	23	62	170%

But the concept and prevalence of debt in capitalist modernity needs to be critically theorised. Our starting point, and primary argument, is that debt within capitalist modernity is a social technology of power and its continued deployment heralds a stark utopia. Our claim is not that debt can be thought of as a technology of power but rather that debt is a technology of power. By technology we simply mean a skill, art or manner of doing something connected to a form of rationality or logic and mobilised by definite social forces. In capitalism, the prevailing logic is the logic of differential accumulation and given that debt instruments far outweigh equity instruments, we can safely claim that interest-bearing debt is the primary way in which economic inequality is generated as more money is redistributed to creditors.

This fact not only has implications for growing inequality and the rise of the 1% and billionaire class. As many of us are aware in IPE, the fear of ballooning public debts is virtually always the perennial justification for neoliberal austerity politics. It seems that almost everyone is living beyond their means but the bankers and the 1%. But when we critically examine how new money enters the economy, the need for neoliberal austerity policies should be understood as a *political choice* rather than one that is historically inevitable by some iron law of debt and public spending. These policies (privatisation, fiscal discipline, deregulation, cutbacks, layoffs, user fees, more indirect taxes, tax cuts for the wealthy, etc...) also tend to cause incredible damage to the livelihoods and well-being of ordinary people, not to mention the most vulnerable.

So why are neoliberal austerity policies a *political choice* rather than a *historical necessity*? The story in brief, drawing from *Debt as Power* and the additional work to come, can be told as follows.

First, let us consider the simple fact that there is considerable mystery when it comes to understanding money and specifically how new money enters an economy. It is highly likely that our politicians do not have a clear understanding of monetary mechanics and are themselves beholden to 'received truths' passed down by generations of faulty or misleading scholarship – particularly in Economics where money is treated as *unimportant* and a neutral veil. In our view, money and particularly the production of it, is far from neutral and involves perhaps the most important power relationship in capitalism (see the seminal and vastly understudied work of Geoffrey Ingham, *The Nature of Money*). So our first point is that we are governed by politicians who likely have: 1) no understanding of how money enters the economy or 2) have a faulty, muddled or outdated understanding of how new money enters the economy.

As it turns out, this is an excellent situation for the private social forces that actually do *own and control* how new money enters the economy. Our money supply, as it were, is *capitalised by the owners of commercial banks*. So now, let's take a closer look at how new money actually does enter an advanced capitalist economy like the United States.

Many would be surprised to find out that the vast majority of the money supply in leading capitalist countries (we have focused on the US and UK in our research) is issued by commercial banks when they make loans – over 90% in most advanced capitalist economies. Most of this money does not consist of notes and coins, but numbers in computers organised by double-entry bookkeeping. This form of bookkeeping is an *historical creation* that has been naturalised and taken for granted rather than

critically examined for its effects.

But now is not the time to take double-entry bookkeeping to task. Let's focus on *why* the fact that banks create money is crucial for understanding neoliberal austerity policies as a political choice rather than a product of some iron law that must be followed to the letter.

The important point is this: most people assume that banks are intermediaries. That is, they take money in from savers and because it is assumed the savers don't need their money right away, the bank is able to lend some of this money at interest to willing borrowers. This view is completely wrong. In reality, when banks make loans to willing borrowers – individuals, businesses and governments – they are creating new money as deposits in the accounts of their customers. For example, if I take out a loan or a credit card for US\$10,000, the bank records this as a **liability** (they owe me this credit facility) on their balance sheets. To offset the liability side of the balance sheet, they record my promise to pay (remember, we sign a contract for loans and credit cards) as an **interest bearing asset**. The contract is the bank's asset and the loan/deposit, the bank's liability. This has been confirmed by the recent work of Josh Ryan-Collins et. al., *Where Does Money Come From?*. It should also be noted that Post-Keynesians and neo-chartalists have also recognised endogenous money but have oddly never problematised the fact that banks create new money when they issue loans. While this research has hardly caused a dent in mainstream or popular thinking across the world, even Martin Wolf of the *Financial Times* had to recognise the glaring facts in a 2014 article.

What this means is that our democracies have relegated the power to create new money to privately owned (though publically traded) commercial banks (with a key role for central banks of the world not discussed here). There is a rich history of how this arrangement came about and we explore this in our work, but the key point to emphasise in this blog post is that if our governments want to spend more money than they take in in taxes, fees and fines, they are *structurally forced to borrow at interest*. There is no legitimate reason why this has to happen, but there is a historical one and it has to do with power, inequality and ultimately a very tiny minority getting something for nothing. Put simply, there is a structural reason why the collective 'national' debts of the world's governments currently stands at US\$ 58 trillion and counting according to the *Economist's* debt clock.

Economist

So the question now becomes who are our governments borrowing from? As it turns out, there are five major sources: 1) individuals/families who purchase government debt as a safe investment – typically through a financial vehicle and/or intermediary; 2) non-financial corporations can place surplus cash in government interest bearing securities; 3) foreign governments and corporations; 4) domestic commercial and central banks; and 5) government entities.

But of these five options, *it is only the domestic commercial and central banks that have the power to create money for the purpose of purchasing government securities*. In other words, whereas the other four options involve investing money that is already in existence, when domestic commercial and central banks purchase government securities they do so by creating the money and expanding their balance sheets accordingly. Effectively, this means that the owners of commercial banks are getting something for nothing.

Though Marx never developed a theory of the capitalisation of the state or of money creation, he did notice this relationship of getting something for nothing in the first volume of *Capital: A Critique of Political Economy*:

The state creditors actually give nothing away, for the sum lent is transformed into public bonds, easily negotiable, which go on functioning in their hands just as so much hard cash would... It was not enough that the bank gave with one hand and took back more with the other; it remained, even whilst receiving, the eternal creditor of the nation...

And indeed, because our governments have been structured historically not to create money (with the exception of notes and coins in most instances), the public is forced to go into debt to private social forces. But the big question is whether this has to be the case? Why shouldn't our democratically elected governments have the power to create interest free money rather than enter a debt relationship with private social forces who capitalise the production of money at interest? This latter process, as we have seen, leads to mounting 'national' debts, the primary justification for the policies of neoliberal austerity.

Of course, because of years of misleading propaganda on the riddle of inflation combined with the popular denigration of public servants and institutions (stronger in some countries than in others) many would react in horror to the proposal that governments

should be in control of the production of new money. There are undoubtedly real and perceived challenges to overcome when considering sovereign money but the alternative is to let the bankers continue to create new money out of thin air and profit from the interest. But there are indeed proposals to create sovereign or public money that avoids inflation and at their centre are two simple propositions: 1) money should be produced interest free and in a planned and democratic way; and 2) this new money should be spent on productive activities that benefit society and urgently address climate change and the need for renewable energy among defeating other unnecessary social ills like homelessness, poverty and hunger.

If you think that this is impossible, consider the fact that Switzerland will be holding a referendum on whether to stop private banks from creating new money while putting the control of new money creation solely in the hands of the Swiss National Bank. The elected government will then instruct the Swiss National Bank how it should spend new money into the economy, closely monitoring the effects of new money creation.

Today, much of the new money created by banks has gone into speculative asset inflation, particularly in real estate and the stock markets of the world. And this brings us to some of the key consequences of allowing commercial banks to issue the majority of the money supply and to charge interest for it. We can list them as follows:

- Democratic governments are not in control of most of their money supply and are structurally forced into debt to a minority of private social forces who profit from this relationship. The fact that the state has the power to tax the population allows for private social forces to capitalise on this power process and direct a stream on income to themselves through government securities. As Creutz pointed out long ago, it is a mathematical certainty that due to the ownership of government securities (the minority) and the payment of taxes (the majority) more money will be received by the minority of the bondholders from the majority of taxpayers. See also the forthcoming book from Sandy Brian Hager on *Public Debt, Inequality and Power* in the United States of America;
- While governments do set spending, distribution and allocation priorities based on a budget, it is largely commercial banks that set allocation/distribution priorities for society given that they are the primary institutions of new money creation. Banks need not create money for productive purposes and can create money to speculate on securities and real estate;
- There is always more debt in the system than the ability to repay. This is because when banks create loans they *do not* create the interest. For example, a US\$100 dollar loan at 10% interest will mean that the borrower has to repay US\$110 to discharge the loan. But the bank creates only US\$100, not US\$110. The money has to be obtained from elsewhere, which is also a key trigger for the need for economic growth and the greater commodification and monetisation of nature;
- The sabotage of the possibility of public or sovereign money and the private ownership of the capacity to create new money leads to an inevitable need for credit/debt when incomes do not meet spending expectations or a desired lifestyle. For example, most people are forced into debt if they want to buy a home or car. But as Susanne Soederberg points out in her wonderful book *Debtfare States*, many low income groups have been turning to consumer credit just to make ends meet; and
- Money/debt is based on creditworthiness and tied to assets and income, hence the already rich can borrow more money, leading to greater inequality. For example, hedge fund managers can typically leverage their assets by about ten times, meaning if they have assets of US\$1 billion, they can borrow another US\$10 billion from commercial banks to speculate on income-generating assets. We have to recall that a 5% return on US\$10 billion is far greater than a 5% return on US\$ 1 billion! Hence, the proliferation of hedge fund billionaires;
- The owners of banks essentially profit from a fraud. Fraud is typically understood to be a deliberate deception in order to secure an unfair gain or advantage. Since the banks create new money and do not act as intermediaries between savers and borrowers, they are indeed deceiving the public and certainly are securing unfair financial gains. There is a reason why the banking sector is the most heavily capitalised sector of the global economy each year and that an orgy of bonuses and luxury spending follows each fiscal year. See below:

Pic1

- Interest on money/debt is a key driver of differential inflation. Interest is a cost to business and gets pushed on to consumers. So consumers not only pay for the base costs of a good or service, but also a portion of the interest the business owes to the banks as well as whatever mark-up on costs the business feels it can get away with. This is interest inflation and profit inflation. Just so that we're clear that most businesses do not finance their expansions out of their retained earnings, here's the level of non-financial corporate debt in the United States (and we assume a similar trajectory in capitalist economies):

pic2

- Government fiscal policy is incredibly important and has more to do with monetary policy than the monetary policy of central banks – which basically regulates the inter-bank market. This is so because should an economy stagnate with low or negative growth and high unemployment then it is only the government that can help create effective demand by spending into the economy. The only problem with this solution is that, at present, thanks largely to Keynes' denial of sovereign money, governments are forced into debt at interest to do so when they need not be;
- There is another consequence for entrepreneurs who may have a great idea but not enough money to invest in their business to make it viable. Since banks typically do not lend to new small businesses without collateral or some other guarantee, this means that entrepreneurs have to turn to venture capitalists and the like for an investment and therefore give up equity in their companies; and
- We need to abandon the notion that savings lead to investment. This is false. No saving has to take place before new

money can be issued. Furthermore, more saving means less money in an economy, not more.

There is considerably more to debate and discuss, but I hope this blog post is enough to encourage scholars in IPE to talk more about money – particular before the next crisis hits, debt mounts and politicians cry out for balanced books and more austerity. When we learn that the current system is a historical legacy/creation and in no way a natural or inevitable one, using debt as an excuse to make certain political choices that ultimately benefit the 1% and undermine the public will hopefully be a non-starter.

Democratic societies should be in control of their own money supply, not a minority of private bank owners and their functionaries who profit enormously from capitalising on everyone else paying interest.

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